COMMONWEALTH OF MASSACHUSETTS
BEFORE THE
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY

Petition of Western Massachusetts Electric Company for authorization for approval to issue long term securities in an amount not to exceed $105 million in principal, and to enter into interest rate hedges, pursuant to G.L. c. 164, § 14, and for an exemption from the competitive bidding requirements of G.L. c. 164, § 15, and the par value requirements of G.L. c. 164, § 15A.	)	D.T.E. 02-49

INITIAL BRIEF OF WESTERN MASSACHUSETTS ELECTRIC COMPANY

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I. INTRODUCTION

On September 6, 2002, Western Massachusetts Electric Company ("WMECO" or the "Company") submitted to the Department of Telecommunications and Energy ("Department") its request, pursuant to G.L. c. 164, § 14, to issue and sell up to $105 million in aggregate principal amount Long-Term Debt: (a) with a maturity ranging from 2 to 30 years; (b) in the form of secured or unsecured notes or bonds; (c) carrying either fixed or floating interest rate; (d) insured or uninsured; and (e) distributed to either retail or institutional investors. Petition, p. 4. The proceeds are to be used to replace a portion of currently outstanding short-term debt, to manage the Company's Prior Spent Nuclear Fuel ("PSNF") liability, and to pay for issuance costs. *Id*. In addition, WMECO requested authority to enter into interest

rate hedges in order to reduce earning volatility, minimize loss, and manage risk. Petition, p. 5.

Finally, WMECO requested an exemption from the requirements of G.L. c. 164, § 15, pertaining to advertisement of the debt issuance for the purpose of obtaining proposals, and from the requirements of G.L. c. 164, § 15A, pertaining to the issuance of all debt at par value.

The September 6, 2002 filing included the pre-filed direct testimony of Randy A. Shoop, Assistant Treasurer – Finance of Northeast Utilities and its system companies, including WMECO. A considerable amount of additional material was also submitted to the Department on September 6, including pro forma financial statements and a demonstration of compliance with the Department's net plant test. Mr. Shoop's September 6 testimony and exhibits have been marked as Exh. WM-1.

On December 12, 2002, WMECO supplemented the record with additional testimony from Mr. Shoop, a draft indenture to hold funds for the payment of the PSNF liability, a draft investment policy for funds held in the trust fund, revised pro forma financial statements, and a revised demonstration of compliance with the net plant test. Mr. Shoop's December 12, 2002 testimony and exhibits have been marked as Exh.WM-2.

After proper notice of this proceeding, the Attorney General intervened. No other party petitioned to intervene. On February 25, 2003, the Department held a hearing in this matter. At that time, Mr. Shoop and Mr. Jeffrey R. Cahoon, Director of Revenue Requirements of Northeast Utilities Service Company, testified for WMECO in support of its requests. The Attorney General did not sponsor any witnesses.

At the hearing on February 25, Exhibits WM-1 and WM-2 were moved into evidence. In addition, WMECO responses to Department data requests DTE-1-1 through DTE-1-37 and DTE-2-1 through DTE-2-4 were also made part of the record, as was Department Exhibit DTE 3-1. Further, the Attorney General's one information request, AG-1-1, was also received into the record. Subsequent to the hearing, the Company responded to one record request of the Attorney General (Exh. AG-RR-1) and one record request of the Department (Exh. DTE-RR-1).

II. STANDARD OF REVIEW

The standard of review for the Department to approve the issuance of stock, bonds, coupon notes or other types of long-term indebtedness by an electric or gas company is well established.[1] The Department must assess, for the purposes of G.L. c. 164, § 14, that the proposed issuance is "reasonably necessary for the accomplishment of some purpose having to do with the obligations of the company or the public and its ability to carry out those obligations with the greatest possible efficiency." *Boston Edison Company,* D.T.E. 00-62 (2000); *Fitchburg Gas & Electric Light Company v. Department of Public Utilities*, 395 Mass. 836, 843 (1985), *citing Fitchburg Gas & Electric Light Company v. Department of Public Utilities*, 394 Mass 671, 678 (1985);

In addition, the Department must determine whether a company has met the net plant test derived from G.L. c. 164, § 16. *Colonial Gas Company*, D.P.U. 84-96 (1984). Under the net plant test, a company is required to present evidence that, after the proposed issuance, its net utility plant (original cost of capitalizable plant, less accumulated depreciation) equals or exceeds its total

[1] Long term refers to a period in excess of one year from the date of issuance. G.L. c. 164, § 14.

capitalization (the sum of its long-term debt and its preferred and common stock outstanding). *Id.*, p. 5.

III. WMECO'S FINANCING PROPOSAL SATISFIES THE DEPARTMENT'S STANDARD OF REVIEW UNDER G.L. c. 164.

A. The Replacement of WMECO's Outstanding Short Term Debt Is Warranted.

1. The Short Term Debt Replacement Is Reasonably Necessary To Accomplish A Legitimate Utility Purpose.

Mr. Shoop testified that WMECO has approximately $81 million of outstanding short term debt that was incurred through revolving and system money pool borrowings. Approximately $50 million of that amount "reflects WMECO's investment in working capital and construction projects, which has now reached a level and stability where it is essentially used by WMECO as permanent debt" (Exh. WM-1, p. 2).

Further, the Company has identified a number of advantages associated with the replacement of the approximately $50 million in short term debt and disadvantages with not going forward. First, reliance on short term debt for what is now essentially permanent capital subjects WMECO to refinancing risk. Exh. WM 1, p., 3. In addition, the short term debt utilizes available short term debt capacity, which is restricted both by the Securities and Exchange Commission and, in practice, by financial institutions willing to lend to WMECO to meet its short term liquidity needs. *Id.* Third, as Mr. Shoop testified, interest rates for long term debt are near historic lows; the market now is very attractive for issuers as a lot of investors are competing to lend. Exh. WM-1, p. 3; Tr., p. 98. Finally, WMECO's financial strength and its credit rating have improved markedly in recent years (Tr. pp. 41, 101-102; Exh. WM-1, p. 4; Exh. AG-1-1) and replacing the approximately $50

million portion of outstanding short term debt provides WMECO with an opportunity to pass on to its customers (in the form of lower interest rates) the benefits of this improved financial strength. Exh. WM-1, p. 3.

WMECO has explained the length of maturities that would be considered in any refinancing, the relative advantages of institutional and retail debt, the evaluation of market conditions that would take place, some estimates of the coupon rate and the types and magnitude of fees that would be associated with any issuance. Exh. WM-1, pp. 15; Tr., pp. 36-40, 81-84, 89-92, 96-99.

As shown above, WMECO has demonstrated that its proposal to replace short term debt is a legitimate utility purpose. No party has taken issue with this portion of the Company's request.

2. The Company Meets The Net Plant Test With Ease.

Mr. Shoop testified that as of September 30, 2002, WMECO's net utility plant (utility plant less accumulated depreciation and less construction work in progress) is $391,147,000. In comparison, the sum of WMECO's outstanding stock and long term debt is $134,381,000. Exh. WM-2, pp. 7-8. Accordingly, the addition of $105 million in new long term indebtedness (the approximately $50 million short term debt replacement and the concurrent reduction of the PSNF liability) increases the sum of its outstanding stock and long term debt to $239,381,000. As Mr. Shoop stated at hearings, this level remains approximately $151,000,000 less than net utility plant. Tr., pp. 1227-129; *see, also,* Exh. WM-1, exh. 5. Accordingly, the net utility plant test under G.L. c. 164, § 16 is satisfied. No party has taken issue with this portion of the Company's request.

3. The Department Should Approve WMECO's Request To Replace Short Term Debt.

WMECO has shown that the replacement of short term debt with permanent debt serves a legitimate utility purpose and that the additional long term debt (either separately or in combination with the PSNF trust fund) meets the net plant test. The Attorney General has not raised any objection to WMECO's issuance of permanent debt. Accordingly, the Department should approve WMECO's request to replace approximately $50 million of short term debt with long term debt.

B. The Financing Of WMECO's PSNF Liability Is In the Best Interests of Customers And Should Be Approved.

1. Background

The genesis of WMECO's PSNF liability is the Nuclear Waste Policy Act of 1982. As Mr. Shoop testified:

> Under the Nuclear Waste Policy Act of 1982, WMECO (along with other owners of nuclear generating stations) is required to pay the U.S. Department of Energy ("DOE") for the disposal of spent nuclear fuel and high-level radioactive waste. The DOE is responsible for the selection and development of repositories for, and the disposal of, spent nuclear fuel and high-level radioactive waste. For nuclear fuel used to generate electricity prior to April 7, 1983, an accrual of approximately $48 million has been recorded on WMECO's books for the spent fuel liability relating to its ownership of Millstone [nuclear power station] ("PSNF liability") and payment must be made to the DOE prior to the first delivery of such prior spent fuel to the DOE. The DOE has not yet finalized its plans for the disposal of spent nuclear fuel and accordingly has not yet required shipment of such fuel or payment of such PSNF liability [Exh. WM-1, p. 3].

As indicated by the above, the PSNF liability represents a fixed obligation and continues to accrue interest at the three-month Treasury bill rate until payment is made. Exh. WM-1, p. 4. Customers' rates reflect the need to pay interest on the PSNF liability. *Id.*

A significant change occurred with respect to the PSNF liability in March 2001 as a result of the sale by WMECO of its interest in Millstone station. As a result of that sale, WMECO became obligated to Dominion Resources, Inc. ("DRI"), the purchaser of Millstone station, for its PSNF liability, rather than to the DOE. However, WMECO remains obligated to pay its share of the PSNF liabilities, including interest. *Id.* As of June 30, 2002, WMECO's current liability is approximately $48 million.

WMECO proposes to use a portion of the proceeds from its $105 million long term debt issuance to establish a vehicle to fund WMECO's PSNF liability in which WMECO and its customers are the beneficiaries and the owners. Exh. WM-2, p. 2. WMECO does not propose to use any proceeds of the debt issuance for any third party loan, guaranty or endorsement.

2. Characteristics Of The Fund

In his testimony, Mr. Shoop specified the characteristics of the proposed fund in considerable detail. Mr. Shoop testified that a trust fund will be established with an independent trustee, which would be a large, highly-rated banking institution. Exh. WM-1, p. 8. The investment strategy and administration would be controlled by WMECO through Northeast Utilities Service Company, its agent. Exh. WM-2, p. 5. WMECO's investment of the funds in the trust would be as specified in the "Northeast Utilities Spent Nuclear Fuel Investment Policy – Draft" (Exh.WM-2). Funds would be used only for the purposes set forth in such policy (payment of the PSNF obligation to DOE) and could not be used for other purposes. Exh. WM-1, p. 2. Investment of capital in the trust would be targeted to equal or exceed the required DOE accrual obligation. Importantly, the investment will be in very conservative investment instruments. Mr. Shoop testified that the required DOE

accrual obligation is the three-month Treasury bill rate. Tr., p. 64. So, investment in the fund would be limited to:

> high quality money-market type instruments of the United States or other money-market instruments…. So whatever the rate, the absolute rate, is, those money-market instruments should still yield in excess of the 91-day T-bill rate, where that's 1 percent or 2 percent or 3 percent or 20 percent. The character of those investments should still yield greater than the 91-day T-bill rate [Tr., pp. 63-64].

Mr. Shoop testified that it is highly likely that the investment return on the trust would be greater than the DOE accrual obligation. Tr., p. 63.

The ability to invest the fund moneys and earn a greater return than that required by the DOE is a considerable benefit to WMECO's customers because any incremental amount earned above the DOE-required amount will be returned to customers when the fund is dissolved and the required funds are remitted to DOE (through DRI). Exh. WM-2, p. 7. Similarly, in the highly unlikely event that DOE determines that no payment is required for PSNF liabilities or if DOE reduces the amount of payment required, WMECO's customer would receive the amount in the trust fund that exceeds the amount paid to DRI to satisfy the PSNF liability. Exh. WM-2, p. 6. There is no expectation that WMECO would be required to pay additional funds to the DOE (through DRI) for its PSNF liability or that the fund would earn less than that required by the DOE. However, the risk is symmetrical and customers, in that highly unlikely event, would be responsible for any shortfall, as is the case now. Exh. WM-2, pp. 6-7.

3. There Are Many Advantages To The Refinancing of WMECO's PSNF Liability.

In addition to the likely return to WMECO's customers of excess investment income at the time the fund is dissolved, there are several other important advantages to refinancing WMECO's PSNF liability.

First, refinancing will allow costs charged to current customers to reflect the costs of providing service to these customers. The PSNF liability, obviously, relates to the period in time in which WMECO held substantial nuclear generating assets. Pursuant to Department policy and the Electric Utility Restructuring Act of 1997, WMECO has divested its generation assets, including its nuclear generation assets. WMECO is now truly a transmission and distribution company. Tr., p. 52. However, under the present method of treating the PSNF liability, current customers are responsible for interest charges each year on this nuclear generation-related liability. Tr., p. 66. By setting the PSNF liability aside and funding it separately, the Department will be recognizing that the Company has divested and no longer is in the generation business and that, to the extent possible, current customers should not be responsible for the costs or benefits enjoyed by past customers when WMECO was in the nuclear generation business. Exh. WM-1, p. 5.

Second, reflecting the PSNF liability in its current form has skewed WMECO's capital structure to a significant extent, and borrowing to finance the PSNF liability will go a long way to rectifying this problem. Using an amount of the proceeds of the long term debt issuance will allow WMECO's debt/equity allocations to be more appropriately aligned and to track more closely non-ratemaking (or rating agency) debt calculations, which currently treats the PSNF liability as debt. Exh. WM-1, pp. 6-7. WMECO's witness, Mr. Cahoon, explained how the situation developed.

Mr. Cahoon testified that prior to restructuring WMECO owned significant generation resources and was a significantly larger company in terms of assets. Tr., p. 49. At that point, in 1998, WMECO's debt/equity allocation, including the PSNF portion, was approximately 64%/36%. The PSNF liability made only a small

difference in the debt/equity allocation viewed by the rating agencies because overall WMECO's assets were greater and the level of the PSNF liability was less. At that time, the debt/equity allocation viewed from a non-ratemaking perspective was 68%/32%. Tr., pp. 49-50.

By the end of 2002, however, WMECO had divested its generation and had become a much smaller company. Tr., pp. 48, 65. In addition, the PSNF liability had grown somewhat. As a result, ratemaking and non-ratemaking debt/equity allocation had diverged significantly. Tr., pp. 49-50. By December 2002, WMECO's debt/equity allocation, from a non-ratemaking perspective was 55%/45%, which is considered within the appropriate range for a company such as WMECO. Tr., pp. 50-51. However, because the PSNF liability is not considered debt from a ratemaking perspective, the ratemaking debt/equity allocation was approximately 25%/75%. *Id*. Holding this level of debt is "much too low"[2] and it is unlikely the Department would accept such a high level of equity over the long term because equity is more expensive than debt and a higher equity level means high costs to customers. Exh. WM-1, p. 6; Exh. DTE-IR-1-4.

While some discrepancy between the ratemaking and non-ratemaking perspectives is acceptable, the huge discrepancy that exists now is not. Although rating agencies and others view the Company as holding 55% debt in its capital structure, and this level of debt is consistent with what is needed to maintain the targeted BBB+/A3 senior unsecured credit ratings, the ratemaking view is that the Company is holding only approximately 25% debt. Exh. WM-1, p. 6; Tr., pp. 49-51.

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[2] It is much too low because it is a misrepresentation to show that WMECO is financing its operations with 75% equity. This is simply a result of the present treatment of PSNF. Tr., pp. 50-51.

On one hand, then, the Company has an appropriate capital structure and should be attempting to maintain roughly that structure. On the other hand, the Company has a capital structure weighted far too heavily toward equity and should be attempting to increase its debt position. However, if the Company were to try to increase its debt position in the current environment by issuing a substantial amount of bonds, it may be viewed by the rating agencies as increasing its debt to too high a level (at present, as shown above, the rating agencies see WMECO's debt level as within a reasonable range), and potentially negatively affecting its BBB+/A3 ratings. *See* Exh. DTE 1-3.

This problem is largely resolved pursuant to the Company's proposal. Because the PSNF liability is already viewed as debt by the rating agencies, borrowing to finance this obligation will not affect the rating agencies debt/equity allocation. *Id*. Conversely, such a borrowing will affect WMECO's ratemaking debt-equity ratio. Taken in combination with the replacement of short term bonds, the borrowing will increase ratemaking debt to approximately the same general level as non-ratemaking debt. Tr., pp. 50-52. This result will allow the Company to manage its financial affairs into the future without being "whipsawed" between the rating agencies view of the Company's debt levels and the ratemaking view of the Company's debt level. Such a result is clearly in the best interests of WMECO's customers.

Third, it is to customers' advantage to finance the PSNF liability in the current low-interest environment. Tr., pp. 66-67; Exh. DTE 1-1. No one knows exactly when the DOE will require payment of the PSNF liability. But when the payment is required, customers will be impacted because the PSNF liability will no longer be a credit to rate base and the Company will have to borrow to pay the DOE

(through DRI). *Id*. Given the virtual certainty that the DOE will require the PSNF fees and WMECO will have to access the financial markets, it makes obvious sense to access the markets now when interest rates are at an historic low. To wait until the DOE actually requests the funds means that WMECO will have little or no choice as to timing of the issuance and the interest rates may well be significantly higher than at present. Customers would be responsible for those higher rates. *Id*.

Fourth, related to point three, above, it is to customers benefit to shed the interest accrual risk on the PSNF liability now, before rates rise. Currently, customers are charged each year the interest obligation on the PSNF liability. This interest is now at a low level. However, as interest rates rise, and the PSNF liability increases, the interest obligation for which customers are responsible may increase significantly. By financing the PSNF liability and establishing a trust fund, customers will avoid responsibility for these increased interest costs. Tr., p. 67.

Fifth, the PSNF liability is growing each year as interest accrues. Tr., p. 49. It goes without saying that, all things being equal, it is preferable to finance a smaller amount than a larger amount. By financing the PSNF liability now, WMECO would be financing the smaller amount at low rates and avoiding any need to finance a larger amount in the future.

Sixth, financing the PSNF liability will decrease WMECO's average cost of capital, thereby reducing future charges to WMECO's customers. Exh. WM-1, p. 7. As Mr. Cahoon testified, it is estimated that WMECO's average cost of capital will drop (because of the increased percentage of debt), by virtue of its proposed long term financing, from 15.12% to 11.84%, grossed up for taxes (it would decrease from 9.79% to 8.28% before taxes are figured in). Tr., p. 54. The low interest rates currently available for debt make such a dramatic reduction possible. Tr., p. 66.

As the Department is aware, a reduced average cost of capital, overall, is a significant benefit to customers. Exh. DTE 1-8; Tr., p. 54. Instead of paying 15.12% to finance the Company's capital, that number drops by several percentage points. Obviously, any time customers can pay less for WMECO's cost of capital, customers benefit. This benefit will become most tangible when WMECO files its next general rate case. At that time, the choice would be to have customers pay the approximately 15% average cost of capital or to attempt to refinance somehow the PSNF liability then. However, it is unclear how the timing of such a financing meshes with a rate case. And, even more importantly, all the parties know that interest rates are at historically low levels now; they may rise to much higher levels in the future – thus precluding the type of savings that would be realized from a financing now. Tr., pp. 65-67.

Accordingly, for all the reasons set forth above, the financing of the PSNF liability is reasonably necessary to accomplish a legitimate utility purpose and should be approved.

4. In The Short Term The Effect Of The Financing Of The PSNF Liability Is Subject To Offsetting Factors.

While the benefits to customers of the financing of the PSNF liability is clear overall, there are offsetting factors in the short term if one assumes that WMECO does not file a general rate case in the next year or two.[3]

Initially, the financing reduces the average cost of capital from approximately 15.12% to approximately 11.84%, and, as noted above, this is a savings to customers. However, the effect of the financing is to remove the PSNF amount as an offset to

[3] WMECO did not state at hearings when its next general rate case would be filed. The Company is not subject to a rate freeze and may file a general rate case at any time.

rate base. With a larger rate base figure, the overall transition charge revenue requirement increases. Tr., pp. 55-59.

The net impact of the financing on WMECO's first transition charge filing subsequent to the financing depends on the interest rate that would be incurred on the PSNF liability in the absence of the financing. WMECO has been candid in acknowledging that if interest rates remain at historically low levels, the short term effect would be to increase the transition charge revenue requirement. Tr., p. 59. However, the PSNF liability balance is growing each year and if interest rates return to historically observed levels, the reconciliation revenue requirement may also be neutral or positive for customers. Tr., pp. 65-67.

WMECO urges the Department to view any possible short term effect of financing the PSNF liability in the context of the larger positive effect of such a financing. Those long term effects are set forth in Section 2 and 3, above.

5. The Attorney General's Positions On The PSNF Liability Issue Are Misleading.

The Attorney General sets out two points in its brief pertaining to the financing of the PSNF liability. The Attorney General claims that WMECO should refile its petition under G.L. c. 164, § 17A, in order to receive approval for the financing and the PSNF trust fund. The Attorney General also claims that the financing would be harmful to customers. Attorney General Brief, pp. 5-7. The Attorney General is wrong on both counts.

a. The Section 17A claim is frivolous.

The Attorney General contends that G.L. c. 164, § 17A, is relevant because WMECO is loaning its funds to, guaranteeing or endorsing the indebtedness of, or investing its funds in the stock, bonds, certificates of participation or other securities

of any corporation, association or trust. G.L. c. 164, § 17A. It is clear that Section 17A covers instances in which an electric company wishes to loan or invest in a separate corporation or company. As far as WMECO can determine, the statute has never been interpreted to cover a request such as that now before the Department. Here WMECO is petitioning the Department to seek a financing and to use a portion of those proceeds to establish a fund for the sole benefit of WMECO's customers. Exh. WM-2, p. 2.

The weakness of the Attorney General's argument is apparent by a casual review of the cases he cites. The primary case cited is a 1999 Bay State Gas Company case (D.T.E. 99-23). In that instance, Bay State requested approval from the Department of an investment in an electric production facility that would sell its output in the competitive generation market. Order., pp. 1-2. This request bears no resemblance to WMECO's proposal to establish a fund, under its control, for the exclusive benefit of WMECO's customers. The Attorney General also appears to rely on a 2001 Massachusetts Electric Company case (D.T.E. 01-104). In that case Massachusetts Electric Company was, in effect, loaning and/or guaranteeing money pool funds in connection with its merger with Niagara Mohawk Power Corporation. Order, p. 1. Massachusetts Electric Company's request is completely dissimilar to that of WMECO. The Attorney General also cites a Southern Union Company case (D.T.E. 03-03), in which Southern Union petitioned to invest $662.3 million in a separate corporation.[4] Once again, this clearly involves capital being invested in a separate corporation, while WMECO's request does not.

[4] To WMECO's knowledge, the Department has not issued a final decision in the Southern Union Company proceeding.

Further supporting the appropriateness of WMECO's petition is a long line of cases involving the Niantic Bay Fuel Trust. This trust was established for the purpose of facilitating WMECO's (and its affiliate, The Connecticut Light and Power Company's) financing requirements of the purchase of nuclear fuel for the Millstone nuclear station. D.T.E. 99-36, p. 1 (1999). Borrowings in order to fund this trust and related activities were approved by the Department in D.P.U. 873 (1981), D.P.U. 91-129 (1991), and D.T.E. 97-107 (1999). The Department approved these requests pursuant to G.L. 164, § 14, without requiring that WMECO include in its petition any request under G.L. c. 164, § 17A. Those cases, therefore, directly refute the Attorney General's contention in this proceeding. Accordingly, there is no requirement that WMECO list G.L. c. 164, § 17A in its petition for approval in this proceeding.[5]

b. The Attorney General's contentions regarding financial effects are unfounded.

In less than a page in his brief, the Attorney General presents an argument that the financing of the PSNF liability would cost customers $5 million annually. Attorney General Brief, pp. 6-7. In light of the fact that the Attorney General: (1) asked no questions related to customer costs on discovery; (2) asked no questions at hearings on the topic; (2) cites to no discussion about a $5 million cost in the transcript of the hearing (because there was none); and (4) failed to cite any authority for the $5 million cost in his brief, the Attorney General's argument is

[5] Even if the Department were to accept the Attorney General's flawed position that approval of WMECO's proposal requires approval under Section 17A, the Attorney General has failed to show that the Department is barred from viewing WMECO's petition as falling under Section 17A and, on its own initiative, approving it as such. Nothing in the statute precludes such a result and the Attorney General provides no authority to support its argument to the contrary. Attorney General Brief, pp. 5-6 The standard of review for investments under Section 17A is "consistent with the public interest" *Bay State Gas Company,* D.P.U. 19886 (1979). WMECO asserts it has met this standard in this proceeding.

extraordinary. If the Attorney General wished to introduce testimony in this proceeding, he should have presented a witness and then allowed the Company and the Department to cross-examine the witness. Testimony in the guise of a brief is improper.

Regardless of the real number the Attorney General is trying to get to, his approach misses the main point: Managing the PSNF liability to provide the most long term benefit to customers. WMECO acknowledges that there may be no immediate benefit to customers from removing the PSNF liability from rate base and removing the customers' responsibilities for the interest on the PSNF liability. In one sense, WMECO is functioning as an 'investment vehicle' for its customers because its ratemaking capital structure provides a substantial return on the PSNF rate base credit. However, it is likely that this benefit will change as WMECO moves to a higher debt/equity allocation, its rate base increases, and interest rates rise. The Department should be focusing on the long term strategy for WMECO's customers and that strategy should respond to all the benefits from financing the PSNF liability, as set forth in Sections 2 and 3, above. The near-sighted recommendation of the Attorney General is not in the best interest of WMECO's customers and accordingly, the Attorney General's claims should be rejected.[6]

[6] The Department should also reject the odd claim presented in footnote 5 in the Attorney General's brief. The footnote appears to be an attempt to preclude the Department from exercising its statutory authority in this proceeding. The Department has the authority to approve the Company's request whether or not there is an indirect impact on transition costs.

6. WMECO Meets The Net Plant Test With Respect To The Financing Of The PSNF Financing.

As shown in Section A.2, above, the net plant test is met with respect to both the short term debt replacement and the PSNF liability financing. Please refer to that section for a discussion of the net plant test.

7. Conclusion

WMECO has demonstrated that the financing of its PSNF liability is in the best interest of customers. The Company has shown that it is likely that the fund to be established through the borrowing would earn more than required by DOE, thus resulting in a direct benefit to customers. In addition, the financing will have the advantageous effect of matching current transmission and distribution company customers with current transmission and distribution costs and benefits. Also, the financing has the effect of recognizing the restructured entity that is WMECO and will bring WMECO's ratemaking capital structure more in line with its non-ratemaking capital structure, to the benefit of customers. Further, the financing of the PSNF liability will decrease WMECO's average cost of capital and benefit WMECO's customers in the long run, if not sooner. Accordingly, the Department should approve the financing of the PSNF liability as submitted.

IV. THE DEPARTMENT SHOULD APPROVE WMECO'S REQUEST FOR THE ISSUANCE OF A LIMITED TYPE OF DERIVATIVE INSTRUMENTS BECAUSE IT SATISFIES THE STANDARD OF REVIEW AND BECAUSE IT WILL REDUCE EARNINGS VOLATILITY, MINIMIZE LOSS AND ALLOW WMECO TO MANAGE ITS FINANCIAL EXPOSURES.

A. Background

WMECO requests that the Department, pursuant to G.L. c. 164, § 14, authorize the Company to enter into interest derivative (or hedging) transactions

from time to time in connection with WMECO's long term or short term debt.[7] Mr. Shoop testified that

> a derivative is a financial instrument whose value is derived or dependent upon the value of another financial instrument such as interest rates. These instruments are commonly used as hedging tools to optimize an entity's financial position by reducing earning volatility, minimizing loss, and managing exposures and/or risk [Exh. WM-1, p. 15].

Common names for the derivative instruments used in the capital markets are interest rate swaps, treasury-rate locks, caps, collars and floors. *Id*. In his testimony, Mr. Shoop thoroughly discusses all pertinent information relating to the use of derivatives and gives clear and concise examples as to how derivative instruments would work in practice. Exh. WM-1, pp. 16-28.

Within the three larger reasons for the use of derivative instruments set forth in Mr. Shoop's testimony above, there are three more specific benefits to derivative instruments for WMECO. Authority to use derivative instruments will: (1) allow WMECO to "capitalize on changing interest-rate environments by locking-in interest rates in anticipation of future planned debt issuances when interest rates are low"; (2) "allow WMECO to guard against rising interest rates associated with outstanding floating debt"; and (3) "provide WMECO with the flexibility to manage its fixed/floating debt without issuing new debt" (Exh. WM-1, p. 6).

B. The Authority That WMECO Seeks Is Limited And WMECO Will Not Be Engaging In Any Speculative Activities.

The record makes clear that there will be very definite limits on the authority that WMECO may exercise should the Department grant its request

[7] In the alternative, the Department may determine that WMECO does not require authorization for the derivative transactions which it proposes; as proposed by WMECO shareholders, not customers, bear all the risk.

pertaining to derivatives. First, WMECO is requesting authorization to engage only in interest rate derivative instruments, not other kinds of hedges. Tr., pp. 20, 88-89.

Second, the Financial Accounting Standards Board Statement 133 ("SFAS 133") "has significantly tightened up the whole subject of derivative transactions" (Tr., p. 107). It imposes significant restrictions on the type of activities that can be pursued if any entity wishes to be able to take advantage of "Hedge Accounting" under SFAS 133, as WMECO will do. Exh. WM-1, p. 19; Exh. WM-IR-1-19; Tr., p. 21. SFAS 133 "requires an entity to recognize all derivatives as either assets or liabilities on its balance sheet, and to mark-to-market the derivative (*i.e.*, recognize the derivative at fair value) on at least a quarterly basis" (Exh. WM-1, p. 19).

SFAS 133 also limits derivative transactions to the level of outstanding debt[8] (Exh. WM-1, p. 28). Anything more than that is defined as speculative and not something for which WMECO seeks authority or something WMECO wishes to engage in. Tr., pp. 21, 86. WMECO is not seeking derivative transaction authority to engage in speculative transactions and does not propose to engage in any such transactions. Tr., p. 20. Nor is WMECO requesting authority to engage in derivative transactions for the "sake of managing a book or a portfolio of derivative transactions, as one might assume an investment bank would. We are merely using interest-rate hedging transactions as tools to hedge outstanding debt" (that is, either current debt or to-be-issued debt) (Tr., p. 20). Mr. Shoop further testified that "the transactions we will be engaging in are clearly not speculative transactions" (Tr., p. 20). In sum, the SFAS 133 "requirements are very specific, very detailed, very

[8] In addition, WMECO does not seek authority to engage in derivative transactions in which the maturity of the relevant instrument exceeds the stated maturity of the underlying debt. Exh. WM-1, p. 28.

complex" and WMECO will be reviewed for compliance by auditors and the outside investment world. Tr., p. 86.

Third, there will be a series of checks and balances internal to WMECO and its parent, Northeast Utilities, that will ensure that proper procedures are followed with regard to any derivative transactions. Although internal Treasury Department management personnel may execute trades, a great deal of discussion and scrutiny will take place up to and including senior management levels before any risk management transaction is authorized. Exh. WM-1, p. 27. Importantly, the decision to enter into a hedging transaction will not be made by the Treasury Department in isolation. As Mr. Shoop testified, the Treasury Department "would have extensive discussions with senior management, we'd have extensive discussions with management of Western Mass., we'd have extensive discussions with economic advisors and investment banks, and we would collectively form an opinion and a strategy to execute." Tr., p. 94. Further, the Chief Financial Officer ("CFO") of Northeast Utilities (WMECO's parent) ("NU") is responsible for overseeing the Interest Rate Risk Management Policies and Procedures and their implementation throughout the NU system and is responsible to report on these procedures to the Chief Executive Officer of NU, to the Board of Directors of WMECO and the Board of Trustees of NU, and to any committee of the NU Board charged with reviewing these practices. Exh. WM-1, pp. 26-27. The CFO must promptly notify the NU Board of Trustees if there are any material changes in the amount or kind of risk incurred, any changes in procedures, or any material violations of procedures. *Id.*

WMECO's risk management practices are codified in "Interest Rate Risk Management: Treasury Policies and Procedures" (Exh. DTE-RR-1). This document,

which WMECO believes is "state of the art" in regard to risk management, lists all the reporting and oversight requirements. Tr., p. 104; Exh. DTE-RR-1. At hearings, the Department asked questions about Section 5.4 of the document. This section is yet another safeguard on the procedures. It establishes that all risk management activities are subject to review by the NU internal audit department, which reports directly to the NU Chairman. Tr., p. 106.

Fourth, WMECO will enter into derivative relationships only with counterparties whose unsecured senior debt ratings or their parent's unsecured debt ratings are greater than A, as published by Standard and Poor's Ratings Group, (or an equivalent rating from Moody's Investors Service or Fitch Ratings). Exh. WM-1, p. 28. In addition, WMECO will limit its derivative transactions further, to those entities with whom WMECO and NU have a highly established relationship. Tr., p. 112. All transactions will be documented utilizing industry standard International Swap and Derivatives Association ("ISDA") contracts. Exh. WM-1, p. 28.

Fifth, while the ability to engage in derivative transactions is important to WMECO, WMECO does not anticipate engaging in a large number of derivative transactions. WMECO may or may not enter into a hedging instrument with respect to the long term debt issuance that is part of WMECO's application. Exh. WM-1, p. 29, Tr., p. 94. The number of transactions may well be "very limited." Tr., p. 21. The only goal is to have the flexibility to improve the financial position of the Company should the opportunity present itself.

C. Interest Rate Derivative Transactions Are A Benefit To WMECO And They Have Been Approved Previously By The Department.

Mr. Shoop testified that while he did not want to overweigh the benefits that might accrue from derivative transactions, such transactions would make WMECO

financially stronger, to the ultimate benefit of its customers. Tr., p. 130. There is no evidence on the record to take issue with this informed opinion of Mr. Shoop. Indeed, Mr. Shoop also testified that engaging in derivative transactions as requested would not make the Company financially weaker, because of the manner in which WMECO would be participating in the derivative market. Tr. p. 130. There is no risk to customers from the use of derivatives proposed by WMECO. Tr., p. 46.

The Department has recognized that derivative transactions meet the standard of review pursuant to G.L. c. 164, § 14 (reasonably necessary to accomplish a legitimate purpose associated with an electric company's service obligations), and has approved the use of such transactions. In *New England Power Company*, D.P.U. 91-267, New England Power Company ("NEP") requested authority to enter into $617 million of interest rate swaps.[9] NEP set forth three types of derivative transactions in which it wished to engage. First, NEP requested approval to use derivatives "to take advantage of low interest rates prior to the call date of its existing bonds and to provide a hedge against a rise in interest rates for the period between the call date of its existing bonds and the issuance date of new bonds [citations omitted]." Order, p. 8. Second, NEP requested approval to enter into "fixed-to-floating interest rate with a counterparty [footnote omitted]." *Id.* Third, NEP requested approval to "enter into a floating-to-fixed interest rate swap with a counterparty" [footnote omitted]. *Id.* These are the same types of derivative transactions in which WMECO wishes to participate.

[9] The Attorney General participated in the NEP proceeding but did not take a position contrary to NEP's request to engage in derivative transactions.

The Department, after investigation, found in the NEP case that there was credible evidence that savings would result and that risks could be managed (Order, p. 15) and approved NEP's request. As noted in subsection A, above, WMECO's proposal is more protective of customers than the NEP approach, in which customers took the risk of the derivative transactions.

Accordingly, the WMECO proposal is beneficial to customers and supported by precedent.[10] Engaging in derivative transactions is reasonably necessary to accomplish a legitimate electric company purpose associated with WMECO's service obligations. WMECO's request regarding derivative obligations should be approved.[11]

D. The Attorney General's Statement Regarding Derivative Transactions Are Almost Completely Uninformed And Must Be Disregarded.

The Attorney General's comments regarding derivative transactions in his brief (pp. 7-11) exhibit a startlingly low level of understanding. In addition, the Attorney General has a novel approach to the situation in which the facts on the record do not correspond to the position he wishes to take. When that happens, the Attorney General ignores the facts on the record and makes up his own by 'testifying' on brief.

1. The Attorney General Does Not Have His Derivative Transaction Facts Straight.

The tendency to either misapprehend the basis of WMECO's proposal and/or to present completely unsupported statements as fact is evident in the first section

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[10] Other New England public utility commissions have also approved the use of derivative transactions. Exh. WM-1, p. 25.

[11] The net plant test is commonly also applied for requests pursuant to G.L. c. 164, § 14. However, the net plant test is inapplicable to WMECO's request to engage in derivative instruments because the amount of debt outstanding will not change pursuant to such derivative instruments.

of the Attorney General's brief dealing with derivatives (pages 7-8). In this one short section, the Attorney General makes the following unsupported, incorrect claims: (1) WMECO's hedging proposal would benefit shareholders but harm customers by increasing the risk profile of the Company (page 8); (2) the Company does not propose any limits on the dollar amounts of the trades or the persons trading (page 8); (3) the accounting standards do not limit the trading activities but only set forth methods to account for the trades (page 8); (4) hedging risk is not a legitimate business purpose (page 8); and (5) (the most outlandish of all) even if the Company limits itself pursuant to SFAS 133, it would only be so limited four days a year and "[d]uring the other 360 days of each year, the Company could undertake speculative trading without any limitations" (page 8).

WMECO will not dignify these unsupported proposals with extensive rebuttal. However, it makes the following brief response. With respect to (1), if the Attorney General is so sure that shareholders will benefit, then customers will also benefit because shareholders' success will mean that the Company is in a stronger position financially. In any case, there is no support on the record for the claim that customers will be harmed by an increasing risk profile. In fact, the record evidence is directly to the contrary. *See* Tr., p. 46.

With respect to (2), WMECO has, in Section B, above, detailed many of the limits on the Company's derivative trading activities. For example, the Company's Interest Rate Risk Management: Treasury Policies and Procedures (Exh. DTE-RR-1) clearly establish who may execute a transaction, the types of instruments that may

be used, and the limits to which they may be used. The Attorney General appears simply to ignore these facts because they are inconsistent with his position.[12]

With respect to (3), the record shows clearly that the impact of SFAS 133 is much more wide-ranging than how to account for derivative transactions. Mr. Shoop testified that all hedging transactions executed by WMECO will comply with SFAS 133, and that accounting standard sets forth a host of limits, including limits on the level of transactions and documentation of what instrument the Company wants to hedge. Tr., pp. 21, 106-107.

With respect to (4), hedging risk exposure is indeed a legitimate business purpose. To the extent that WMECO can minimize loss, manage risk, and reduce earnings volatility through the use of hedging tools, it is creating a more financially strong organization. Tr., p. 71.

With respect to (5), it is difficult to understand how the Attorney General could claim that SFAS 133 only applies four days a year, and further state that on the other 360 days of the year a company is subject to no limitations on trading. Obviously, there is no support in the record for such a position. SFAS 133 is a permanent, continuous (every day) requirement. Any contrary statement is completely false.

Beyond these specific problems, WMECO also must respond to the Attorney General's frequent use of the term "trading derivatives" (*see, e.g.*, Attorney General Brief, p. 7). WMECO is not seeking to "trade" any financial derivatives and never made such a request in this proceeding. Trading derivatives implies the speculative

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[12] The Attorney General also mentions "value at risk". Value at risk is irrelevant for the purposes of this proceeding because it is simply a statistical analysis tool used to assess the likelihood of losses attributable to large portfolios. WMECO is not seeking to trade or to hold a large portfolio of derivatives, so value at risk makes no sense in this context. Tr., p. 20.

buying and selling of many derivatives within a portfolio over brief intervals in an attempt to obtain quick profits. WMECO does not request any such authority and has no intention of holding a portfolio of derivatives, to speculate on the interest-rate market, or to buy derivatives on a short-term basis. Instead, WMECO seeks to do just the opposite: it wants to enter into derivative transactions to 'hedge' its outstanding or anticipated exposures to minimize loss, manage risk and reduce earning volatility. Tr., pp. 20, 28; Exh. WM-1, p. 20. This is frequently accomplished through the long term buying of derivative 'hedging' instruments, in which the maturity of the derivative matches the maturity of the underlying debt instrument, with the intent to hedge the exposure throughout its tenure. Moreover, SFAS 133 requires a derivative transaction to be designated as a hedge of a specific underlying debt in order to receive hedge accounting treatment, and the Company has stated it will comply fully with SFAS 133 requirements. Tr., p. 86.

2. The Attorney General's Proposal With Respect To Retention of Benefits Is Malarky.

On pages 9-10 of his brief, the Attorney General claims that derivative trading will harm WMECO's customers because WMECO will conspire to obtain a high interest rate on bonds, higher, in fact, than what could really be obtained. The Company will address the Attorney General's meritless claim below. It must be pointed out, however, that after the first sentence of his polemic the Attorney General does not offer one citation to the record to support his position. In fact, what the Attorney General is doing is testifying in the guise of a brief; in this way there is no opportunity for the Department or the Company to challenge in hearings any of the unsupported positions the Attorney General takes. On this basis alone, the Attorney General's statements should be rejected.

Putting aside the fact that the Attorney General's contentions have no support on the record, they do not make sense anyway. First, the Attorney General is charging that WMECO officials will 'rig' a bond solicitation to obtain a more costly result for customers (in direct contradiction to the Company's statements and the whole point of the Company's request). This assumes that WMECO's officials will take an action that is directly contrary to the interests of the entire Company. It is directly contrary to the Company's interest because, should such an action come to the attention of the Department (and it would, somehow, eventually), the Department would, without a doubt, properly penalize the Company's shareholders very harshly. For all the Company knows, the officials responsible, and the Company as a whole, may also be subject to criminal penalties for such an action. Even if there were to be a modest benefit as the Attorney General claims, which is unclear, that is no incentive when the risk of such an action is so drastic.

Second, the Attorney General has not even begun to explain how WMECO could engineer a higher interest rate when investment banks are the parties working to price the bonds. Tr., pp. 97-98. Further, it stands to reason that an investment bank would have a disincentive to price a debt issuance at less than favorable terms to WMECO, because maintaining a reputation for obtaining financing at the lowest possible rates is what produces future business for the investment banks.

Third, the Attorney General's 'examples' require a huge leap of faith. They require that WMECO know exactly how interest rates are going to move. If WMECO does not know how interest rates will move, the Attorney General's hypotheticals fall apart. WMECO contends that it does not and cannot know how interest rates will move and certainly has no more information in that regard than

the general market.[13] The evidence on the record shows that NU has been able to participate to its satisfaction in several derivative transactions but also shows that WMECO does not have any special knowledge or insight about how the market is going to move. Tr., pp. 72-73, 107-111. Accordingly, the predicate of the Attorney General's argument is flawed, and his contention must be rejected.

Although the discussion above indicates fatal flaws in the Attorney General's examples, there are even additional flaws. In both Attorney General examples, customers would pay the coupon, and shareholders accept all the benefits and risk. However, the Attorney General conveniently points out only the benefits that shareholders may obtain, while ignoring the risks. In the first case, there would be an initial gain to shareholders from the lower effective interest rate by converting from fixed rates to floating rates, but that gain would turn to a loss when interest rates rise over time (Exh. AG-RR-1). In the second example, there would be an initial loss to shareholders from the higher interest rate by converting from a floating interest rate to a fixed interest rate (although that loss would turn to a gain over time after interests rates rise).

3. The Attorney General Ignores The Record With Respect To Necessary Human Resources Needed To Enter Into Financial Derivatives Transactions.

On page 10 if his brief, the Attorney General claims that WMECO does not have the necessary expertise or licenses to 'trade' financial derivatives. As indicated above, WMECO is not requesting authority to 'trade' derivatives.[14] If the Attorney

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[13] WMECO posits that if its officials knew the movement of interest rates in advance, they would not be working for WMECO. Instead, they would be on Wall Street trading in the market and making millions, or tens of millions of dollars, a day.

[14] The Attorney General alleges that personnel acting on behalf of WMECO need a license to engage in derivative transactions, but fails to indicate what type of license or what in the record supports such an allegation. This is another claim by the Attorney General

General means to say that WMECO does not have the expertise to enter into derivative transactions, he is wrong and the record proves it.

Mr. Shoop, the Assistant Treasurer of WMECO, has demonstrated a very high degree of knowledge on the subject of derivative transactions. His prefiled testimony is practically a primer on derivatives. Exh. WM-1, pp. 15-29. In addition, at hearings, he answered questions on the subject from the Attorney General and the Department with great knowledge and insight. Tr., pp. 18-33, 45-48, 71-88, 101-115. In addition to himself, Mr. Shoop identified in attendance at the hearing on February 25, 2002, Patricia Cosgel, a member of his staff who is very familiar with derivative transactions and who worked at the Federal Reserve Bank in Boston for a number of years. Tr., pp. 18-19.

Even more important than Mr. Shoop and Ms. Cosgel, perhaps, is the large support system that would be involved in deciding on any derivative transaction. WMECO is a subsidiary of NU, the largest electric company in New England, and Mr. Shoop eloquently testified to the participation of NU officials up to and senior to the CFO in the derivative transaction process. Exh. WM-1, pp 26-27; Tr., p. 108. In addition, as stated earlier, all decisions whether to enter into a derivative transaction will be make only after extensive discussion and consultation with senior management and officials at investment banks. Tr., p. 94. WMECO and NU officials have engaged in derivative transactions previously (Tr., pp. 107-111) and the record completely supports the position that the Company has the needed expertise to engage in derivative transactions in the future.

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with no basis in the record or otherwise. There is no requirement that a license is required for Company employees engaged in WMECO's hedging activities.

4. WMECO Has A State-Of-The-Art Risk Management Policy In Place And It Is In The Process Of Being 'Blessed' By Two Boards Of Directors.

WMECO has a risk management policy in place, contrary to the assertion of the Attorney General (Attorney General brief, pp. 10-11). Mr. Shoop testified that this document, which has been submitted to the Department (Exh. DTE-RR-1) has been worked on extensively to make it a state-of-the-art product. Tr., p. 104. As part of this process, WMECO and NU have been talking with investment banks and reviewing other companies' risk management policies and procedure. *Id*. Exhibit DTE-RR-1, however, is not substantively different from the earlier version of the Company's risk management policies provided in response to an earlier information request (Exh. DTE-IR-1-28). (Nor is it significantly different from the actions taken with respect to earlier derivative transactions taken by NU personnel. These actions are now being more formally codified. Tr., p. 93.) There have been 'cosmetic' changes but the only significant change is that WMECO's Board of Directors, as well as NU's Board of Trustees will have to approve the policies and procedures. Tr., pp. 93, 104. In any case, senior management has reviewed the most recent version of the risk management policies and procedures and it is anticipated that the WMECO and NU Boards of Directors will approve this document on April 16, 2003. Tr., pp. 104-105, Exh. DTE-RR-1. Accordingly, the Attorney General's assertion that WMECO does not have a risk management policy in place that guarantees the financial health of the Company is without merit, and should be rejected by the Department.

V. THE DEPARTMENT SHOULD GRANT AN EXEMPTION FROM SECTION 15 OF CHAPTER 164 OF THE GENERAL LAWS.

In its petition, WMECO requests an exemption from the requirement in the General Laws requiring WMECO to invite proposals for the long term debt issuance and the derivative transactions through advertisements in certain newspapers. G.L. c. 164, § 15; Exh. WM-1, p. 30. In his pre-filed testimony, Mr. Shoop stated that:

> It would be in the public interest for the Department to grant such an exemption because there is already a measure of competition in the Company's solicitation of various investment bankers with broad experience in the debt markets and access to potential investors. In addition, an exemption is in the public interest because such an exemption provides WMECO with the ability to respond quickly to changes in market conditions and to facilitate the use of a variety of pricing mechanisms and take full advantage of market conditions and obtain maximum attention from potential investors. Requiring competitive bidding pursuant to § 15 could jeopardize the flexibility sought in these circumstances [Exh. WM-1, p. 30].

At hearings, Mr. Shoop reiterated the need for the exemption. He testified that WMECO is in "constant dialogue with investment banks and their capital-markets groups" and these activities allow WMECO to "achieve the same goal as this general statute [§ 15]" Tr., p. 96. He further indicated that the advertisement requirement, if not waived, would create the possibility that WMECO would "miss an opportunity" for customers. Tr., p. 117.

The Department has previously recognized the benefits of waiving the requirements of § 15. In *Boston Edison Company*, D.T.E. 00-62 (2000), the Department stated "…the process provides adequate competition for the issuance of its securities consistent with the objectives of newspaper advertising. In addition, it is appropriate to allow the Company the flexibility offered…to assist the Company's timely entry into the financial markets. Therefore, the Department finds that it is in the public interest to exempt the Company from the requirement of G.L. c. 164, s

15." Order, p. 11. *See also, e.g., New England Power Company*, D.P.U. 91-267 (1992), in which the Department used very similar language to approve an exemption from G.L. c. 164, § 15.

No party has objected to WMECO's request for the waiver from G.L. c. 164, § 15. Based on the unrebutted evidence in this proceeding and the Department's precedent, WMECO's request should be granted.

VI. THE DEPARTMENT SHOULD GRANT AN EXEMPTION FROM SECTION 15A OF CHAPTER 164 OF THE GENERAL LAWS.

In its petition, WMECO requests an exemption from the par value requirements of General Laws chapter 164, , § 15, in connection with the issuance of long term debt. Mr. Shoop stated in his pre-filed testimony that:

> Such an exemption is in the public interest because market conditions may make it difficult for WMECO to price all of its debt at par value and simultaneously offer an acceptable coupon rate to prospective buyers. Investors rely on such discounts as a means to refine the price structure of a debt instrument to achieve a desired interest rate. Consequently, a discount provision offer enhanced flexibility…. Such flexibility could benefit WMECO's customers in the form of lower interest rates and a lower cost of capital [Exh. WM-1, pp. 30-31].

At hearings, in response to a question from the Department, Mr. Shoop expanded on this statement by testifying that investors may want a certain coupon rate and it may not be possible to give them that rate with an issue at par. The ability to vary from a par issuance is "just a very fine-tuning process to meet with market conventions." Tr., pp. 100-101. Such flexibility gives the purchaser when it needs and, in turn, benefits WMECO's customers.

The Department has previously approved exemptions from the par value requirements of G.L. c. 164, § 15A. For example, in *Boston Edison Company,* D.T.E. 00-62 (2002), the Department found that:

> the ability to issue debt securities below par value offers the Company increased flexibility in placing its issuances with prospective investors. This increased flexibility translates into an ability to issue debt securities in a timely manner to take advantage of favorable market conditions. Therefore, the Department finds that it is in the public interest to exempt the Company from the requirements of G.L. c. 164, § 15A. Order, p. 12.

No party has objected to WMECO's request for the waiver from G.L. c. 164, § 15A. Based on the unrebutted evidence in this proceeding and the Department's precedent, WMECO's request should be granted.

VII. CONCLUSION

Based on the above, the Department should determine, consistent with G.L. c. 164, §§ 14, 15, 15A and 16, that:

a. the issue by WMECO of up to $105 million aggregate principal amount of long term debt is reasonably necessary to enable WMECO to refinance a portion of current short-term borrowings and finance WMECO's PSNF liability;

b. the aggregate principal amount of long term debt to be issued hereunder shall not exceed $105 million;

c. WMECO may issue and sell the long term debt in one or more separate series, depending on market conditions at the time, in a total amount not to exceed $105 million, during the period through December 31, 2003;

d. granting an exemption from the requirements of newspaper advertisement of a public invitation for proposals in G.L. c. 164, § 15, is in the public interest and shall be granted with respect to the issue and sale for the long term debt and the entering into of derivative instruments;

e. granting an exemption from the requirement of issuance at par in G.L. c. 164, § 15A, is in the public interest and shall be granted with respect to the issue and sale of the long term debt;

f. WMECO may engage in derivative transactions in connection with any outstanding or prospective short term or long term debt and that such is in the public interest; and

g. WMECO has met the requirements of the net plant test.

Respectfully submitted,

WESTERN MASSACHUSETTS
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Dated: March 18, 2003

IV. THE DEPARTMENT SHOULD APPROVE WMECO'S REQUEST FOR THE ISSUANCE OF A LIMITED TYPE OF DERIVATIVE INSTRUMENTS BECAUSE IT SATISFIES THE STANDARD OF REVIEW AND BECAUSE IT WILL REDUCE EARNINGS VOLATILITY, MINIMIZE LOSS AND ALLOW WMECO TO MANAGE ITS FINANCIAL EXPOSURES..... 18

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